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GOLD RESERVES.

BY

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GOLD RESERVES.

Mr. E. H. Holden, M.P. for the Heywood Division of Lancashire, and Managing Director of The London City and Midland Bank Limited, in opening the Debate on the Gold Reserves before the members of the Bankers' Institute at the London Institution, on Tuesday evening, January 15th, 1907, remarked that Sir Felix Schuster had laid down two important propositions, the first one being "It is one of the first duties of every State to provide a sound currency," and the second being "That the necessity for an increase of the national reserve of gold seems amply proved," two important propositions with which he entirely agreed. But, he asked, did the recommendations which had been made fit in with the propositions?

The principal recommendations were, first, that the bankers should provide eight millions of gold, such gold to be kept as a second reserve in the Bank of England never to be used except under circumstances of exceptional emergency; and secondly, that notes should be issued against securities by the Bank of England to an extent equivalent to a given proportion of the gold, say two millions or three millions, such notes only to be used to meet an internal demand. Mr. Holden contended that these recommendations did not fit into either the first, or the second proposition. The circulation to be issued against this gold was not a circulation provided by the State, but was a circulation dependent upon the gold provided by the Joint Stock Banks, and it would not increase the national reserve of gold, because it belonged to the bankers, and would not perform the functions which are performed by the ordinary national reserve of gold.

The recommendations, while falling short of the important proposition laid down, were also, in the opinion of Mr. Holden, unsound on banking principles. The shareholders of a bank were responsible to their depositors, and in a much lesser degree they had a moral responsibility to the public and the State. Shareholders of banks relied on their directors to keep adequate reserves to meet liabilities. For a body of directors to transfer five hundred thousand pounds from the reserves of any bank to a special reserve at the Bank of England, and at the same time to give power to the Bank of England to issue notes against it, which notes might be in the hands of the public, would be to lock up that sum and render it unavailable to meet the liabilities of the bank in question in case of necessity. Such a proceeding appeared to Mr. Holden to be *ultra vires* and he could not conceive that any body of shareholders would allow such a transaction to take place. Mr. Holden contended that the recommendation to transfer gold to the special reserve in the Bank of England might lead to a decrease of the national reserve of gold. For example, if bankers who now hold a reserve in Bank of England notes, exchanged these notes for gold to be placed in the special reserve, then he would have curtailed the note issue and the national reserve of gold and would have gained no advantage.

Mr. Holden was strongly of opinion that we should be able to keep in this country more gold if the gold held by the joint stock banks were unseen. Other countries were able to retain their gold by placing restrictions upon it, and he contended that by maintaining the eight millions of gold unseen, a restriction would be placed upon it which would have the same effect as the restrictions placed on the gold in other countries. For these reasons he condemned the recommendation of the gold provided by the joint stock

banks being placed in a special reserve at the Bank of England, and being kept in full view of the whole world. He condemned the recommendation also from another point of view. If this special reserve were shown week by week, and one of the banks desired to withdraw its portion of the gold, criticisms on the withdrawal might be made, and the bank withdrawing the gold might be pointed out as being in difficulties, or suspicion might be thrown on the whole of the banks. It would, therefore, appear to him to be a much sounder policy for the bankers to hold the gold in their own vaults, but even under these circumstances it would be necessary not only to hold a reserve of gold, but also to hold a reserve in Bank of England notes, in order to prevent a permanent contraction of the bank note circulation, which of course, as previously stated, would mean a contraction of the national reserve of gold.

Sir Felix Schuster had said, he believed, that it would be unwise for the bankers' balances to be increased with the Bank of England, on the ground that the shareholders of the Bank of England would make additional profit at the expense of the shareholders of the joint stock banks. Mr. Holden agreed with Sir Felix that the balances should not be increased but for the following reasons :—

The balances of the joint stock banks with the Bank of England were alleged to amount to a minimum of twenty millions. If that were so, assuming that the ratio of reserve to its liabilities be 50 per cent., the loan fund of the Bank of England in respect to those balances would not be less than twenty millions. If the balances of the joint stock bankers were transferred to the Clearing House, and the Clearings effected by certificates in the same manner as is adopted by the Bankers' Clearing House in New York, then there would be no additional loans created on the amount

in the Clearing House. It followed, therefore, that the reserves of the joint stock banks which were kept at the Bank of England had two loan funds created, namely, the loans created by the joint stock banks themselves, and the loans created by the Bank of England. It would thus be seen that the joint stock banks not only assisted the commerce and industry of the country by means of their own loans, but they further assisted the commerce and industry by keeping their balances with the Bank of England, and thus enabling at least twenty millions of additional loans to be created. Mr. Holden thought that the joint stock banks had gone quite far enough when they permitted twenty millions of their reserves to be used twice. He thus agreed with Sir Felix Schuster, but for different reasons.

Sir Felix and the President of the Institute of Bankers had come to the conclusion that it was advisable to have the bankers' balances with the Bank of England published separately. Mr. Holden was sorry to differ from them on that point, and for the following reasons:—

When the joint stock bankers had lent up to their recognised ratio of reserves to liabilities, they could stop lending, but the Bank of England was not quite in the same position, for when no additional funds could be had from the joint stock banks, borrowers went, as a rule, to the Bank of England. If the Bank of England stopped lending, then difficulties would ensue. They therefore were compelled in order to meet the demands of trade to allow their reserves to run down below their recognised ratio. Under circumstances of great demand, it might happen that the reserve of the Bank of England would fall even below the balances of the joint stock banks. To publish such a condition of affairs to the whole world might injuriously affect not only the position of the

Bank of England, but also our whole financial position as the centre of international finance.

The recommendation that a committee of joint stock bankers should act with the Bank of England had Mr. Holden's hearty approval, because it had been clearly demonstrated that, in cases where the rates for money in the outside market had fallen away from the Bank-rate and thus jeopardized our national reserve of gold, at such times when the Bank of England had sought and obtained the co-operation of the joint stock banks, the outside rates had speedily approximated to the Bank-rate, and the national reserve of gold had as speedily been protected.

To the publication of weekly balance sheets, or of monthly balance sheets on the basis of averages, Mr. Holden would be favourably inclined if the fortnightly settlements on the Stock Exchange became, as in New York, daily settlements. Under present conditions of fortnightly settlements, if a bank desired to sell some of its securities, leaving of course Consols out of the question (which might be sold for cash); or desired to call in loans from the Stock Exchange to meet extraordinary demands, or, if its customers desired to sell securities in order to pay off loans, they would be unable to do so within fourteen days. To publish its balance sheet weekly or to show its weekly average, might expose it to unfair criticism and even might affect its position.

Having dealt with the recommendations of Sir Felix Schuster, Mr. Holden proceeded to construct a policy for increasing the national reserve of gold permanently, and in doing so he contended that it was necessary to have one national reserve of gold, but with one part absolutely without restrictions in order to maintain our international financial position, and with another part placed

under restriction so that that portion of the gold could not be taken away, and in fact could not be used except in case of a national emergency. To have a portion of our reserve in the second condition would be to maintain greater commercial confidence under ordinary circumstances, and to protect our financial position under extraordinary circumstances. He believed this could be done by adopting the proposition "that it is the duty of every State to provide a sound and adequate currency." The currency which our country has provided is the Bank of England note, which is regulated by the law of 1844, and the Bank of England note has provided our national reserve of gold. Sir Robert Peel, in his Act of 1844, divided the Bank of England into two departments, the Issue Department, which, as Mr. Cole, a Director of the Bank of England, had said, might be situated in Whitehall, while the Banking Department is situated in Threadneedle Street, each being independent of the other. The Issue Department of the Bank of England is really an exchange department. It takes in gold and gives out the equivalent in Bank of England notes, and it takes in notes and gives out their equivalent in gold. The amount of gold taken into this department in exchange for Bank of England notes constitutes our *national reserve of gold*, and our national reserve of gold depends on the amount of notes which can be issued by this department. It will thus be seen that the Bank note is really the instrument which governs the amount of gold in our national reserve. In the return issued by the Bank of England last Thursday the gold in the Issue Department amounted to about 30½ millions, and of course the notes issued against this gold were of a similar amount, but in addition to the notes issued against this gold other notes, amounting to eleven millions, were issued against no

gold at all, but against an indebtedness of the Government. In addition to these, there were also issued seven millions four hundred and thirty-five thousand also not against gold, but against securities. As it is impossible to issue Bank of England notes beyond the demands of the country, it follows that the greater the amount issued against securities, the less will be the amount issued against gold, and the notes issued against securities will tend to drive out of circulation the notes issued against gold, and thus diminish the amount of gold in the national reserve.

Sir Robert Peel made a serious mistake in the Act of 1844, when he stipulated that if a country bank ceased to do business, its note circulation should lapse, but that two-thirds of the lapsed issue should be issued by the Bank of England against securities. Attention has been called to this by the financial authorities in New York, who have pointed out that the gold held in the national reserve in 1905 was about three millions and a half less than in 1879, because an increased issue of notes against securities to that amount had driven out gold to a similar amount.

Turning now to the period from 1880 to 1905, the gold of the Bank of France increased ninety millions, and this gold had been increased because the Bank of France had the power to increase its notes to a similar amount, while, during the same period the Bank of England only increased its gold seven millions on a similar amount of notes issued. The question arises why the Bank of France was able to put out ninety millions of notes while the Bank of England was only able to put out seven millions of notes. There were, of course, several reasons for this. The development of banking in this country, and the consequent increase of cheques; the development of the Savings Bank System, of the Postal

Order System, and of the Clearing System. In addition to these, there was another important reason. France had a population of 39 millions, while England and Wales had only a population of $32\frac{1}{2}$ millions. The Scotch and Irish banks issue their own notes. The Scotch banks cater for $4\frac{1}{2}$ millions of population, and the Irish banks for an equal population. If the Bank of England could issue notes for the whole of the United Kingdom, our national reserve of gold would be £15,000,000 larger. The Bank of England is at a disadvantage, because while Scotland and Ireland rely to a certain extent on the national reserve of gold in the Bank of England, they both deprive the Bank of England of the power of increasing that reserve by issuing its own notes.

At the present time Ireland and Scotland can issue uncovered by gold £9,030,000 notes. They really issue £15,241,000 as they have to provide gold for an excess of notes over the former figure, it follows that they must hold about $6\frac{1}{4}$ millions of gold. They obtain this gold by driving in the Bank of England note, taking out gold, and against this gold issuing Scotch and Irish notes. If this issue were Bank of England issue then the gold in the national reserve would, as he said before, be increased by £15,000,000.

While the Bank of France had in its Bank notes the power of increasing its gold, it also made use of a restriction in order to retain its gold.

It is well known that if a cheque be presented at the Bank of France, that cheque may be paid in silver. Is it advisable for this country to adopt the same restriction? If this be done, London would lose its international financial position. The first person who would protest against our international position being destroyed would be the Chancellor of the Exchequer,

because he would know there would be a great loss of profit, which would affect the revenue which he derives from the Income Tax, and from the taxation on cheques and bills. If it be not advisable to adopt this course in order to increase our national reserve of gold, is it advisable to curtail our banking system, so as to approximate to the banking system of France? The effect of such a curtailment would be to reduce the deposits of our banks, to reduce their reserves, and to reduce their loans. The accommodation given to trade would have to be curtailed. That again would reduce profits and wages, and would diminish the revenue from Income Tax, and from the taxation of cheques and bills. Mr. Holden apprehended the Chancellor of the Exchequer would be sorry to see any curtailment of our banking system. Not being able, then, to increase the issue of notes by either of these methods, they must look in a different direction for accomplishing their object. Mr. Holden asked his audience to imagine a circle, and to further imagine a figure of fifty millions inside the circle. This figure represented the average amount of Bank of England notes issued and kept out during the last ten years. If they could get outside the circle and keep out ten millions of additional notes, then they would get ten millions of additional gold, but as the present conditions of the country do not allow the putting out of any notes beyond the fifty millions inside the circle, the national reserve of gold could not be increased if the Issue Department remained under present conditions. The question then arises, as only fifty millions of notes can be put out, Do we really get the greatest amount of gold for them we otherwise could. The answer to that question is "No." They may obtain on the one hand eleven millions more of gold, and on the other hand

seven millions and a half of gold, making together about eighteen millions and a half, but they are prevented from doing this by the operation of the Act of 1844. Mr. Holden dealt only with the eleven millions. The Government had received eleven millions of notes out of the fifty, and against this, of course, the Issue Department had a Government debt. If the Government would hand back to the Issue Department these eleven millions of notes, and thus pay back the debt, then as there is a demand in the country for these eleven millions of notes, it follows that the Bank of England can re-issue them in exchange for gold, coming, say, from South Africa. We should then have in the Issue Department, instead of $30\frac{1}{2}$ millions of gold, a sum of $41\frac{1}{2}$ millions, the ratio of gold to notes would be 85 per cent. instead of 62 per cent. as it is at the present time, and the ratio of securities to notes would be 15 per cent. instead of 38 per cent. The position would thus be materially strengthened. But they were told that we could not use the additional gold for the reserve in the Banking Department, or in other words, that this gold could not be taken away. But was not that exactly what they wanted, and had they not then a restriction placed on the 11 millions of gold similar in effect to the restrictions on the Bank of France gold? In that way they would get a national reserve of gold amounting to $41\frac{1}{2}$ millions, 11 millions of which could not be taken away.

As that additional amount of gold can not be used under ordinary circumstances, the question arises—how could it be used under extraordinary circumstances, the extraordinary circumstances being a national crisis? He first took the case of a national crisis arising in consequence of a drain of the deposits from the Post Office Savings Bank, against which, of course, there was no reserve held

either in Bank of England notes or in gold. If such a drain took place, he said, they were told by a leading official of the Treasury that they would first apply to the Chancellor of the Exchequer and the Governor of the Bank of England, and, secondly, they would sell Consols, and, thirdly, if neither of these expedients proved effectual, the Bank Act would have to be suspended, and an over-issue of Bank of England notes made. Such an issue being made at the present time might convert an internal drain into an external drain, which of course would deplete our national reserve of gold. The only instance of an actual over-issue of notes was in 1857, when the drain was an internal one, and when the reserve of the Bank of England fell down to £958,000, and the gold fell down to six millions. Under the circumstances of the gold being increased in the manner indicated above, they would be able, when the reserve of the Bank fell down to a dangerous figure, and the Bank of England rate was at 6 per cent. or any other agreed rate to create an issue of notes against securities, even to an amount of eleven millions without placing themselves in any worse position than they were at the present time. If they had had conditions existing in 1857 such as were advocated, Mr. Holden asserted positively that in his opinion there would have been no panic in that year. It was thus shown that by adopting this expedient the Post Office Savings Bank would be relieved of the necessity of providing the four millions of gold advocated by Sir Felix Schuster, and just as efficient relief could be had for an internal drain as for a drain arising from any other cause. Further, in case we had an external drain, we should be in a better position by eleven millions than we were at the present time.

The question then arises, would the Government not be justified, under the circumstances, in placing the country in this undoubtedly safe position by paying back the Government debt. To answer this question, Mr. Holden referred to an answer given by the Chancellor of the Exchequer in the House of Commons to a question put to him by Sir Frederick Dixon-Hartland. He said the amount paid in interest on the Government debt of eleven millions at the rate of $2\frac{1}{2}$ per cent. was £275,000, but that the Government received back from the Bank in respect to profits on the note issue the sum of £247,000. If those two amounts were cancelled there would only be £28,000 payable to the Bank of England, and thus the difficulty of the remuneration of the Bank of England would be removed except the payment of this relatively small amount. The loss, therefore, which would accrue to the Government would be the use of the eleven millions of money plus the £28,000 paid to the Bank. The question of the joint stock banks providing eight or ten millions ought not to be mixed up with the question of increasing the national reserve. They would increase their gold for the purpose of protecting their own depositors, and incidentally of protecting the State and the public. If they provided, say, ten millions, it would cost them £300,000. Having regard to the fact that the Government would protect the Savings Banks, and would protect the general financial position of the country, out of the trade of which they derive such large revenues in respect to Income Tax, in respect to taxation on cheques and bills, and in respect to other large sums incidental to trade, and further taking into consideration that if an increase of notes should take place under circumstances described above, they would make considerable profit. Was it not reasonable to ask that the Chancellor of the Exchequer should comply with this request,

seeing that he could not under any circumstances lose a larger sum than the joint stock banks, and in all probability he would lose considerably less.

Mr. Holden then returned to the position of the joint stock banks, and to the contribution of eight or ten millions which they were asked to provide, and remarked, that it was not so easy for the joint stock banks to provide the above-named amount of gold as it seemed on the surface. In discussing this phase of the question, he laid down the principle that as he was dealing with all the joint stock banks in the country, he must regard them as one unit, or as one bank. That being so, he asked how the reserves were to be increased. The reserves of the banks formed the basis of their loans, and of a corresponding amount of deposits. If the loans were contracted the deposits would be contracted, and the ratio of reserve to liability would be increased, but the reserve itself would not be increased in gold. This would apply also to the loans in the short money market. If these loans were called in, they would reduce a corresponding amount of deposits in the banks. Of course it was well known that if the loans were called from that market, then either other banks would lend and reduce their deposits with the Bank of England, or the brokers would go to the Bank of England themselves. The Bank of England would then create the loan and create deposits, but the reserve of the Bank of England would not be affected—only the ratio. Mr. Holden thought it was well understood that if the loans borrowed by the market did not go to the credit of the banks with the Bank of England, but went bodily into the vaults of the joint stocks banks, the Bank of England would not be able to make any large amount of loans, and he thought it was quite clear that in case there was no Bank of England to go to, that the calling in of loans

from the market would mean a reduction of deposits, and that again would mean an increase in the ratio of reserve to liabilities, but not an increase in the reserve of gold. The chief way, if not the only way, to increase the reserves of the joint stock banks in gold would be to draw notes out of the banking department of the Bank of England, and with them take gold from the national reserve in the Issue Department. This of course would lead to a contraction of the note issue, a contraction of the gold reserve, and a contraction of the reserve at the Bank of England. Up to this point the gold in the country would not be increased, but a vacuum being created in the reserve of the Bank of England, it would be necessary to put up, and keep up, the Bank of England rate until the vacuum in the reserve had been filled up by notes issuing from the Issue Department in exchange for gold imported. In this way the balances of the joint stock banks in the Bank of England would be replenished to their old figure, and the joint stock banks' reserves would be increased in gold. Taking the figures of the twelve monthly publishing London banks, Mr. Holden found that the average of the deposits for 1904 was £349,000,000, for 1905 it was £364,000,000, and for the eleven months of 1906 it was £364,000,000. The average reserves for the same period were in 1904 £54,000,000, in 1905 they were £56,000,000, and for the eleven months of 1906 they were £56,000,000. The average loans for 1904 were £194,000,000, for 1905 they were £194,000,000, and for eleven months of 1906 they were £200,000,000. The average short loans in 1904 were £40,000,000, in 1905 they were £49,000,000, and for eleven months 1906 they were £49,000,000. It would thus be seen that during the three years the loans had increased by 6 millions, and the short loans by 9 millions, and that

those two items practically created the increase in the deposits of 15 millions. These figures showed clearly that the loaning capacity of the banks was at their full stretch, and it could not be increased any further without reducing the ratio of reserve to liability. The average ratio in 1904 was 15·7, in 1905 it was 15·3, and in the eleven months of 1906 it was 15·5. The banks therefore were confronted with two difficulties, firstly an increase in the price of commodities, and a continued increase of business, both of which might lead to an increased demand for loans which, if granted, would result in diminished percentages. The other difficulty was the demand of the public for increased reserves. It followed, then, that if the bankers increased their reserves by locking up gold in their vaults, or in a special reserve, which of course was equivalent to an export of gold, it would be necessary to have a continued high Bank-rate.

In addition to the twelve publishing banks, the other banks in London, exclusive of the Bank of England, held about one hundred and eighty-two millions. The banks in the country held about one hundred and seventy-five millions, the Irish and Scotch banks held about one hundred and sixty-eight millions, making a total of eight hundred and eighty-eight millions.

What would be the verdict of the whole of these bankers? The first criticism Mr. Holden apprehended they would make would be as to the foreign banks doing business in London. Although these banks may not collect deposits in this country yet they were incurring large liabilities here by reason of their acceptances and their endorsements, and as public opinion demanded that the English bankers should strengthen themselves against their liabilities, was it not reasonable to propose that the foreign bankers should provide also proper reserves in gold against their liabilities?

Would the home bankers wait until legislation was forced upon them, or would they move of their own volition ; if they waited until legislation compelled them to move, they might be confronted with a demand of the legislature that they should not only publish monthly balance sheets, but other restrictions might be placed upon them, such as a compulsion to keep a fixed reserve (in which case they would be placed practically in the same position as the New York banks) which would destroy the elasticity of our banking system which had done so much good for the country, and he suggested that it would be much more to their advantage to act without the law being put in force against them. How should they act ? Mr. Holden suggested that the additional reserve of one per cent. of the credit balances should be held separately from the other reserves, and a return should be made each quarter to the committee proposed, the figures of which return should be kept private. While they would thus accumulate the reserve required in gold, they would still have it under their own control, and it would be available in case of necessity. Although they would make a loss year by year by reason of this increased reserve, yet they would to some extent recoup themselves by the increased rate of interest which they would get on their loans. Mr. Holden concluded by remarking that if his line of policy were to be carried out the State would have performed its duty by providing a sound and adequate currency which in its turn would increase the national reserve of gold, and the increase of the national reserve of gold would maintain commercial confidence. On the other hand, the depositors of the banks would have additional protection in the increased gold reserve, and the objection of the Savings Bank not keeping adequate reserves would to a large extent be dissipated.

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